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Fintech gears up for the latest wave of M&A action

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As young financial technology companies continue to attract increasing amounts of venture capital funding, investment bankers are expecting more mergers and acquisitions activity in the sector.

The growth in fintech funding and innovation will generate a new cohort of companies big enough to start acquiring others – or with the scale to make them meaningful bolt-ons to existing large players.

However, activity is expected to be patchy. The booming payments sector has already seen deals and is expected to see more. But less mature sectors such as peer-to-peer lending may need more time before consolidation takes off.

“There is no doubt it is going to be a bigger market, and we expect to see more M&A. These businesses are growing rapidly, so it clearly will be a bigger portion of the overall market," said Markus Boser, head of technology, media & telecoms banking for Europe, the Middle East and Africa at JP Morgan.

"Are bankers thinking more about it? Definitely," he said.

Fintech companies raised $3.79 billion globally from venture capitalists in the first six months of the year, up 37% from 2014, according to figures from data provider Pitchbook. It was the highest first half of the year on record, the data provider said.

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Steve McLaughlin, a managing partner at US-based fintech-focused investment banking firm FT Partners, said that the dramatic uptick in venture capitalist and private equity funding into fintech is "a huge leading indicator for future M&A and IPO activity in the space".

"Obviously not every firm will make its way to an IPO, but even if funding were to dry up, there will always be pressure to create exits for investors either through a sale or an IPO," McLaughlin said.

Philippe Cerf, co-head of TMT M&A for Europe, the Middle East and Africa at Credit Suisse, noted that the level of start-up creation and innovation in London is "unprecedented".

Although Cerf believes a wave of fintech M&A might not happen within the next 12 months, he noted that there will be "a new generation of companies that are scaling, and will eventually either go public or be sold. So there is definitely a lot more activity now than five years go."

Figures on fintech M&A deal flow vary significantly because most data providers do not yet classify it consistently. However, data from New York-based investment bank Berkery Noyes shows that there were 343 deals in the financial technology and information industry in 2014, 8% higher than 2013, with transaction value up by just 5% to $28.7 billion.

One busy sector is payments. The business of moving money used to be the profitable preserve of large banks and specialists such as Western Union, but innovation and the surge in online and mobile payments has created a wave of fresh players who are both creating new markets and taking market share in traditional ones. Four of the industry's five largest deals in 2014 occurred in the payments segment, according to Berkery Noyes. These four transactions had a combined value of $8.97 billion, and accounted for 31% of deal value during the year.

Bankers said activity is being driven by established players needing to buy companies in new markets such as mobile. At the same time, banks under pressure to slim down have in some cases sold off profitable traditional payments business, with private equity stepping in.

Talk of the town

"Every sponsor only wants to talk about fintech when you speak to them now, it is the flavour of the day," said the head of technology investment at a major bank. In June Nordic bank Nordea sold its card payments business to private equity-owned payments company Nets for €230 million. Nets was acquired by buyout firms Advent and Bain Capital, alongside Danish pension fund ATP in 2014 for $3.14 billion from a consortium of regional banks.

John Meehan, a partner at London-based Arma Partners, said: “We see a lot of private equity firms that are looking for platforms in the fintech market. So they are basically investing in a management team and then they will use that to consolidate a part of the market.”

Nordic Capital bought Stockholm-based card acquiring company Euroline from bank SEB Group for around €111 million in May last year.

Boser expects sustained activity in payments. He said: “That entire area will continue to consolidate, there is pressure to upgrade infrastructure and deal with margin pressure.”

Deal flow in payments might also be boosted by potential moves from large technology companies, bankers say. McLaughlin at FT Partners said: “Payments has clearly led all verticals over the past several years and we expect this will continue into the foreseeable future as giant firms with huge balance sheets like Apple, Facebook, Google and Alibaba have entered the market and will continue to challenge the incumbents.”

Making a move

Large technology companies have already made acquisitions in the mobile payments space. In February Samsung bought US mobile payment start-up LoopPay, while Google bought Softcard from three major telecoms carriers in February. Terms were not disclosed in either deal. Although big tech firms such as Google and Apple have very deep pockets, bankers caution that big moves into the fintech sector such as moving deeper into payments may be a long time in coming – if they come at all – because they do not like to operate in sectors with tight regulation.

Tobias Warkus, a director at ACXIT Capital Partners in Frankfurt, said: “Our experience is as soon as the big technology firms hear about regulatory issues – and this is something you have in most fintech sectors – they are still very conservative.”

ACXIT advised German payments company Sofort during its $150 million sale to Swedish peer Klarna in 2013. One Silicon Valley firm that bankers say could drive more M&A activity is newly-independent PayPal. The payments company, which demerged from eBay this week, could become an attractive target for companies looking to strengthen their online payments offering or could start acquiring other payments firms. Indeed this month it acquired San Francisco-based money transfer company Xoom for $890 million. PayPal did not respond to requests for comment.

Moving away from payments, bankers suggest that newer areas of fintech such as marketplace lending, big data analytics and online wealth management might only see a wave of M&A in the next three to five years. There has already been some consolidation by younger fintech companies, such as Klarna’s acquisition of Sofort and Trustbuddy’s acquisition of Italian and Dutch peer-to-peer lenders Prestiamoci and Geldvoorelkaar for a total consideration of €15.9 million in 2014. In 2015 German lender Kreditech’s bought Polish firm Kontox, though terms were not disclosed.

Many banks may be planting the seeds for potential acquisitions, through newly established venture funds to invest in young fintech companies.

Alexis Thieriet, a managing director at FTCL, a fintech corporate finance firm, said: “Financial services firms will sometimes choose M&A as a way to try to adapt to the challenges posed by fintech."

Next on the hit list

Another group of companies seen as likely targets are data providers. Bankers point to incumbent financial data providers such as Markit, Bloomberg and Thomson Reuters, who have historically been aggressive buyers. Already this year Markit has bought software company Information Mosaic, though terms were not disclosed.

A Markit spokesman said the company sees "opportunities in the fintech space" as acquisitions are part of its strategy to accelerate growth, while a Thomson Reuters spokesman said M&A are not the only way for young companies to grow in the financial industry, citing its initiatives to collaborate with external developers on applications.

Less action is seen among marketplace lenders, sometimes known as peer-to-peer lenders. Although the sector's explosive growth (lending by the platforms has risen an average by 123% a year since 2010, according to a report by Morgan Stanley) has spawned several companies with billion-dollar valuations such as Funding Circle and Lending Club with the means to acquire smaller players, bankers say consolidation is not yet on the horizon. The easy availability of private funding to continue to fuel growth and their fast organic growth has meant acquisitions are not yet high on their agenda, advisers say.

Still, the field is fragmented and at some stage consolidation is seen as inevitable. Boser at JP Morgan noted: "Within consumer peer-to-peer lending one could argue that there are too many firms, so you could see that consolidating, but I think it is still too early to see a mega consolidation trend, which is evident on the payments and processing side."

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